Testimony of the Honorable Rick A. Lazio
President and CEO – The Financial Services Forum
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Madame Chair, Ranking Member Gutierrez, and former colleagues: Though many of you know me, I am Rick Lazio and I am the President and CEO of the Financial Services Forum. The Financial Services Forum was organized in February of 2000. It is composed of the chief executive officers of twenty of the largest and most diversified financial institutions in the United States. The purpose of the Forum is to promote policies that enhance savings and investment in the United States, and that ensure an open, competitive and sound financial services marketplace that contributes to the long-term growth of the American economy.

Our members believe that ending the double taxation of dividends will benefit investors, strengthen the capital markets and improve our long-term growth prospects. This measure will stimulate the economy in the short-term; however, the longer-term positive consequences are most important.

<u>Direct Benefits to the Investor</u>

The most obvious benefit to ending the double taxation of dividends is the promotion of steady dividend payments to investors. Within normal ranges of share prices and business performance, individual investors receive cash in hand with reasonable certainty – an immediate on-going return on share holdings. This flow of funds enhances the lives of American families, retirees, and other individuals in our society. Currently many shareholders receive the benefit of stock ownership only when they sell their stock. Clearly it is desirable to increase investor benefits in a manner that does not require stock sales to achieve. Ending the double taxation on dividends also gives the average investor a simple basis upon which to evaluate equities – the value of the dividend.

<u>Benefit to the Economy</u>

Double taxation of dividends results in the inefficient allocation of our nation's resources. Companies are penalized for returning funds to shareholders. Under current law, businesses are incented to reinvest earnings, which often could be put to better use elsewhere. Eliminating these perverse incentives leads to a more efficient capital market and a far more productive economy.

This measure would also make American firms more competitive in the international arena by lowering their cost of capital.

<u>Removing the Incentive to Issue Debt</u>

It has been clear for some time that double taxation has created a bias in favor of debt as opposed to equity capital because of the deductibility of interest payments. We have seen, over and over again, that excessive levels of debt become problematic during an economic downturn. Firms with too much leverage do not have sufficient flexibility to cope with adverse market conditions, to the detriment of their shareholders. Eliminating the double taxation of dividends removes the bias toward corporate debt, encouraging more equity in capital structures, which allows firms to weather adversity and protect investors in difficult times.

Removing the Bias Towards Share Repurchases

Double taxation encourages corporations to engage in share repurchases, because current tax law permits the distribution of earnings in this manner at lower capital gains tax rates. Investors, however, do not realize the cash benefit of a share repurchase until they sell their stock. Eliminating the double taxation of dividends makes it more likely that shareholders will receive higher dividends and realize corporate gains without selling their stock.

Promoting Better Governance

Because the tax code discourages payment of dividends, publicly traded companies often are focused on goals that can become problematic. Under present circumstances, shareholder value tends to be equated with an appreciation of stock price by many firms. Regrettably we have observed too many companies resorting to accounting manipulation to inflate earnings and stimulate stock price appreciation. Correcting the bias against dividends will cause both firms and their investors to emphasize cash flow and cash dividends as true and more appropriate measures of firm value.

Conclusion

In summary, removing the double taxation of dividends results in significant benefits to individual Americans and American families. This measure will restore balance to the manner in which publicly traded firms are managed by removing incentives to issue excess debt, repurchase shares, invest retained earnings in sub-optimal investments, and designing unproductive strategies to avoid taxes and inflate earnings. We believe that eliminating the double taxation of dividends will cause firms to focus on creating true value for shareholders and other stakeholders. Share prices of dividend paying stocks tend to be less volatile, and thus are a stabilizing force in the capital markets.

Eliminating the dividend tax will contribute in a major way to restoring and increasing confidence in our markets and contribute to long-term productive growth in the economy. Finally, this proposed change would correct a fundamental lack of fairness in the tax code by ending the bias against equity capital and dividends and increasing the competitiveness of US firms.